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Tax Update for Lawyers

A paper presented by Denis Barlin at the
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Ken Schurgott	E ken@sbnlawyers.com.au	D 02 8247 3320 M 0403 069 821
Denis Barlin	E denis@sbnlawyers.com.au	D 02 8247 3310 M 0404 848 311
Andrew Noolan	E andrew@sbnlawyers.com.au	D 02 8247 3330 M 0437 002 061

Denis Barlin will address some of the latest issues relating to superannuation and estate planning with respect to trusts.

All references in this paper are to:

- The *Income Tax Assessment Act 1936* (Cth) (**'the 1936 Act'**);
- The *Income Tax Assessment Act 1997* (Cth) (**'the 1997 Act'**);
- The *Superannuation Industry (Supervision) Act 1993* (Cth) (**'the SIS Act'**); and
- The *Superannuation Industry (Supervision) Regulations 1994* (Cth) (**'the SIS Regulations'**).

About sbn lawyers

As a firm we offer commercial and taxation solutions to problems faced by SME clients and their advisers.

We have experience providing the following legal and tax advisory services.

- preparation of commercial documentation such as contracts, leases, trust deeds, declarations of trusts, employment contracts
- negotiation on sale or purchase of a business
- negotiating with the ATO to settle tax disputes
- advocacy before the AAT in taxation disputes
- advice on business structuring
- advice on the taxation consequences of business purchases and acquisitions
- preparation of ruling requests and objections
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- provision of tax training

These materials represent the law as it stood on 24 March 2011.

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Superannuation

1 Changes to contributions caps

From 1 July 2007, contributions for which a deduction is allowed are referred to as a 'concessional contributions'. Concessional contributions, whether made by the member or an employer, are included in the assessable income of the superannuation fund. Undeducted contributions are referred to as 'non-concessional contributions'.

Generally speaking, concessional contributions are either employer contributions and deductible personal superannuation contributions that are included in the assessable income in the recipient's superannuation fund.

Self-employed or substantially self-employed persons may be entitled to a deduction for contributions into a complying superannuation fund or an RSA. Generally speaking, being substantially self-employed means that the individual earns less than 10% of their income in a year from employment-related activities. If the individual satisfies the deduction conditions, then there is no limit on the amount of deductible contributions that may be made. However, excess contributions tax may be imposed if the contributions exceed the contributions cap for the year.

That is, despite the full deductibility of 'concessional contributions' to the contributor, there are limits on the amount of concessional contributions that can benefit from concessional treatment when paid to the fund (i.e. subject to 15% tax when contributed into the fund and potentially 0% when paid from the fund as a superannuation benefit). Concessional contributions which exceed the cap are subject to excess concessional contributions tax of 31.5%.

Similarly, excess contributions tax at 46% is imposed on non-concessional (i.e. undeducted) contributions where those contributions exceed the relevant cap amount for the year. It should be noted that non-concessional contributions are subject to no tax when contributed into a superannuation fund, and may be subject to no tax when paid out as a superannuation benefit.

Contribution caps for the financial year 2010/2011:

Type of contribution	Age requirement	Cap amounts	Tax on contributions over the caps
Concessional	Less than 50 years old	$25,000	31.5% (plus 15% which is already paid by the fund) AND Amounts over the concessional cap count towards the non-concessional contribution cap
	50 years old or more	$50,000	As above

Non-concessional	65 years old or more (to contribute you must satisfy certain criteria)	$150,000	46.5%
	Less than 65 years old	$450,000 over a 3-year period	46.5%

From 1 July 2007 new limits on how much can be contributed to superannuation apply.

Contribution type	Age requirement	Annual dollar limit 2010 - 2011
Concessional	Less than 50 years old	$25,000 (indexed)
	50 years old or more (ends 30 June 2012 then see above)	$50,000 (non-indexed)
Non-concessional	Less than 65 years old	$150,000 (indexed) or $450,000 (non-indexed) over a 3-year period
	65 years old or more	$150,000 (indexed)

The change in the concessional contribution cap amount (i.e. from $50,000 to $25,000), coupled with the tax effectiveness and asset protection advantages of superannuation, have caused gearing in superannuation to become a popular method of increasing superannuation balances. This attractiveness has been further heightened given the volatility with respect to equities and the preference of many towards real estate investments.

2 Gearing in superannuation funds

On 3 November 2006, the Minister for Revenue and Assistant Treasurer, the Hon. Peter Dutton, M.P. in Press Release No. 078 ('**the Press Release**') announced that instalment warrants contain an element of borrowing, and are therefore a prohibited investment for superannuation funds. This is notwithstanding longstanding practice and that '*Over a number of years instalment warrants have been marketed to superannuation funds — particularly to self managed superannuation funds (SMSFs)*.'[1]

Further, both the Australian Prudential Regulation Authority and the Australian Taxation Office (collectively '**the Regulator**'), both being the regulators of the superannuation industry, had previously formed the view that instalment warrants did not involve a 'borrowing'.

Indeed, the Regulator had issued guidelines as to what constitutes a borrowing for the purposes of section 67 of the SIS Act. The Regulator, in Superannuation Circular No II.D.4 entitled *Borrowing by superannuation entities* ('**the Borrowings Circular**'), considered that not all liabilities incurred by a superannuation fund would be a 'borrowing'. As an example, the Regulator at paragraph 16 of the Borrowings Circular distinguished between 'borrowings' and other debts:

[1] See also paragraph 3.6 of the Explanatory Memorandum.

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'… in general ... a borrowing involves receiving a payment from someone in the context of a lender/borrower relationship on the basis that it will be repaid. A transaction that gives rise to a debtor/creditor relationship does not necessarily give rise to a lender/borrower relationship and hence does not necessarily represent a borrowing for the purpose of the restriction.'

Further, the Regulator, at paragraph 17 of the Borrowings Circular, provided examples of borrowings, which includes a loan (whether secured or unsecured) and a bank overdraft (in normal circumstances). However, at paragraph 19 of the Borrowings Circular, the Regulator considered that the following would not be a borrowing:

*'… amounts paid on behalf of, or owed by, regulated superannuation funds … [that include] … the purchase by a trustee of property where ownership of the property passes to the trustee before the instalments are finalised. Under this example, an investment in **endowment warrants or instalment receipts** may not be considered borrowing. It is necessary to check the obligations that lie with the purchaser to meet the instalment(s), as these determine whether the investment is a borrowing. Where the **remaining instalment(s) is not "compulsory"** and the **warrant / receipt holder receives the value of the warrant / receipt (less handling or sales costs)** on "default", APRA considers the warrant / receipt does not constitute a borrowing.'* [emphasis added]

Further, the Regulator at paragraph 6 of the Borrowings Circular gives examples of endowment warrants and instalment warrants as not involving borrowings by a Fund. The Regulator reiterated the views that it expressed in the Borrowings Circular regarding instalment warrants in the *Guidelines on Instalment Warrants for Superannuation Trustees* ('**Guidelines**'):

*'… prohibition on borrowing was developed before many currently available geared products had been developed … The regulators had previously taken the view that a superannuation fund investment in an instalment warrant **may not** constitute a borrowing under section of the SIS Act.'* [emphasis added]

2.1 Prohibition against borrowing in superannuation funds

Notwithstanding the change in the Government's view as announced in the Press Release, the *Tax Laws Amendment (2007 Measures No 4) Bill 2007* (Cth) ('**the Bill'**) amended the SIS Act so as to ensure that investments in instalment warrants do not breach the prohibition against trustees of regulated superannuation funds from borrowing. Subsection 67(1) of the SIS Act expressed the prohibition, by providing that:

'… a trustee of a regulated superannuation fund must not

(a) borrow money; or

(b) maintain an existing borrowing of money.'

However, there are a number of exceptions to the prohibition contained in subsection 67(1) of the SIS Act, which includes (as a result of the enactment of the Bill) the former subsection 67(4A) of the SIS Act. Subsection 67(4A) of the SIS Act was repealed by *Superannuation Industry (Supervision) Amendment Act* 2010 which commenced on 7 July 2010. The former subsection 67(4A) was replaced by sections 67A and 67B.

Sections 67A of the SIS Act provide:

‘(1) Subsection 67(1) does not prohibit a trustee of a regulated superannuation fund (the RSF trustee) from borrowing money, or maintaining a borrowing of money, under an arrangement under which:

(a) the money is or has been applied for the acquisition of a single acquirable asset, including:

(i) expenses incurred in connection with the borrowing or acquisition, or in maintaining or repairing the acquirable asset (but not expenses incurred in improving the acquirable asset); and

Example: Conveyancing fees, stamp duty, brokerage or loan establishment costs.

(ii) money applied to refinance a borrowing (including any accrued interest on a borrowing) to which this subsection applied (including because of section 67B) in relation to the single acquirable asset (and no other acquirable asset); and

(b) the acquirable asset is held on trust so that the RSF trustee acquires a beneficial interest in the acquirable asset; and

(c) the RSF trustee has a right to acquire legal ownership of the acquirable asset by making one or more payments after acquiring the beneficial interest; and

(d) the rights of the lender or any other person against the RSF trustee for, in connection with, or as a result of, (whether directly or indirectly) default on:

(i) the borrowing; or

(ii) the sum of the borrowing and charges related to the borrowing;

are limited to rights relating to the acquirable asset; and

Example: Any right of a person to be indemnified by the RSF trustee because of a personal guarantee given by that person in favour of the lender is limited to rights relating to the acquirable asset.

(e) if, under the arrangement, the RSF trustee has a right relating to the acquirable asset (other than a right described in paragraph (c))--the rights of the lender or any other person against the RSF trustee for, in connection with, or as a result of, (whether directly or indirectly) the RSF trustee's exercise of the RSF trustee's right are limited to rights relating to the acquirable asset; and

(f) the acquirable asset is not subject to any charge (including a mortgage, lien or other encumbrance) except as provided for in paragraph (d) or (e).’

Further, sections 67B of the SIS Act deals with replacement assets.

A summary of the key features of the former subsection 67(4A) of the SIS Act is provided in paragraph 1.5 of the Explanatory Memorandum for the *Superannuation Industry (Supervision) Amendment Act* 2010:

'Schedule 1 of this Bill amends the Act to make sure that superannuation fund assets are protected in the event of a default on a limited recourse borrowing arrangement by ensuring that:

- *the recourse of the lender and of any other person against the superannuation fund trustee for default on the borrowing is limited to rights relating to the acquirable asset;*
- *the asset within the arrangement can only be replaced in prescribed circumstances that arise from owning the original asset; and*
- *the borrowing is referable and identifiable only over a single asset (excluding money) or in prescribed circumstances, a collection of assets which are identical and are treated as a single asset.*

A comparison of the key features of the new sections 67A and 67B with the former subsection 67(4A) of the SIS Act is also provided in the Explanatory Memorandum:

New law	Current law
Explicitly defines the interpretation of acquirable asset in the singular.	While the Act refers to 'asset' in the singular, it is possible to interpret asset in the plural.
Ensures that the recourse of the lender or of any other person against the superannuation fund trustee for default on the borrowing is limited to rights relating to the acquirable asset.	The Act limits the rights over the original asset in terms of the direct lender and associated borrowing only.
Limits borrowing arrangements to a single asset or a collection of identical assets together treated as a single asset.	Allows borrowing arrangements over multiple assets which may permit the lender to choose which assets are sold in the event of a default on the loan.
Clearly defines circumstances under which assets can be replaced.	Allows arrangements where the asset subject to the borrowing can be replaced at the discretion of the trustee or the lender.

2.2 The legal relationships required to obtain the borrowing carve-out

It is essential to consider the legal relationships that arise when seeking to avail oneself of the borrowing carve-out in sections 67A and 67B of the SIS Act. The provisions require the following conditions to be satisfied:

Condition	Description
One	A trustee of a superannuation fund borrows money (or indeed maintains a borrowing of money).
Two	The asset that has been acquired by the borrowed money.
Three	The asset that has been acquired is held on trust so that the trustee of

	the superannuation fund has a 'beneficial interest' in the asset.
Four	The trustee of the superannuation fund has an option (i.e. a right to acquire) the 'legal ownership' by making further (instalment) payments.
Five	The right of the lender is limited in recourse – to the asset acquired and held by the trustee.
Six	If, under the arrangement, the trustee of a superannuation fund has a right relating to the asset (other than a right to acquire the underlying asset) – the rights of the lender against the trustee of the superannuation fund are limited to rights relating asset.

That is:

- The trustee of the superannuation fund borrows to acquire the underlying asset (i.e., the '**Investor**');
- The trustee of the superannuation fund needs to have the 'beneficial interest' in the underlying asset;
- The underlying asset is held on trust (indeed – bare trust) for the benefit of the trustee of the superannuation fund (held by a '**Security Trustee**');
- The trustee of the superannuation fund has an option to acquire the underlying asset after paying the loan amount;
- The lender's rights with respect to the borrowing are limited in recourse, to the underlying asset;
- Any rights that the trustee of a superannuation fund has to the underlying asset (except the option to acquire) may be subrogated in the lender, but only to the extent that the rights apply to the underlying asset.

The Security Trustee needs to hold the legal title in the underlying property. The Security Trustee acts as a 'bare trustee' with respect to the underlying property, as the Security Trustee does no more (under the trust relationship) than hold the legal title in the underlying property. It is also essential from a taxation perspective (see discussion below) that the relationship as between the Security Trustee and the Investor with respect to the underlying property is a 'bare trust' - i.e. the Investor is 'absolutely entitled' to the underlying asset and the Security Trustee has no active duty with respect to the underlying asset.

There are a number of contractual relationships that need to be established. A lender / borrower relationship needs to be established as between the lender and the Investor. Under that relationship, the Security Trustee is prohibited from dealing with the underlying asset on behalf of the Investor, unless the Security Trustee is required to do something which involves the discharge of the loan (for example):

- the lender exercises a power of sale with respect to the underlying asset;
- the Investor pays the outstanding amount and the legal title in the underlying asset transferred to the Investor; or

- the Investor wants to dispose of the underlying asset and repay the outstanding loan.

It needs to be ensured that the only right that the lender has (including with respect to the repayment of the loan) is limited to the underlying asset. None of the other assets of the Investor can be at risk. As a result, all of the Investor, the Security Trustee and the lender need to enter into a contractual relationship.

Further, and in some situations, the Security Trustee may be granted a power of attorney by the Investor with respect to the underlying asset, until the borrowing is discharged and the legal title is transferred to the Investor.

The Investor needs to be able to acquire the legal title in the underlying property at any time.

Product Ruling PR 2005/96 entitled *Income tax: tax consequences of investing in ABN AMRO Rolling Instalment Warrants IZY Series 2005 Product Disclosure Statement – Cash Applicants and Secondary Market Purchasers* (withdrawn) ('**PR 2005/96**')[2] outlines the arrangements and the participants involved in the particular warrant product. Paragraphs 18 to 20 of PR 2005/96 outline the participants in the product:

> *'18. ABN AMRO …* [i.e. the financier] *… is the Issuer of the ABN AMRO IZY Rolling Instalments. ABN AMRO is also the provider of the Loans to Investors to fund the acquisition of the Underlying Parcel …* [i.e. the asset to be held subject to the warrant arrangement] *….*
>
> *19. ABNED Nominees Pty Limited …* [i.e. the 'bare' trustee in the warrant relationship] *… holds the legal title to the Underlying Parcel as Security Trustee and as nominee for the Investor.*
>
> *20. The Investors may be individuals, companies, trusts or superannuation funds.'*

Sub-paragraph 17(b) of PR 2005/96 provides that:

> *'Under a Cash Application, a Cash Applicant …* [e.g. a trustee of a superannuation fund] *… pays the First Payment …* [i.e. the initial 'instalment'] *… and draws down the Loan made by ABN AMRO …* [i.e. the financier]. *The First Payment and the Loan Amount is applied toward the purchase of the Underlying Parcel …* [i.e. the asset to be held subject to the warrant arrangement] *… , payment of the First Interest Amount and payment of the Capital Protection Fee and Borrowing Fee (if any).*
>
> *ABN AMRO …* [i.e. the financier] *… purchases the Underlying Parcel …* [i.e. the asset to be held subject to the warrant arrangement] *… in the name of the Security Trustee …* [i.e. the 'bare' trustee in the warrant relationship] *… for the benefit of the Cash Applicant …* [e.g. a trustee of a superannuation trust] *… and takes a security interest over the Underlying Parcel …* [the asset to be held subject to the warrant arrangement] *…'.*

Further, at sub-paragraph 17(e) of PR 2005/96:

> *'… repayment of the Loan will be secured by a mortgage over the Underlying Parcel* … [i.e. the asset to be held subject to the warrant arrangement] *… Legal title to the Underlying Parcel will be held by the Security Trustee …* [i.e. the 'bare' trustee in the warrant relationship] *… on trust for the Investor. Each trust and each Underlying Parcel to which it relates will be kept as a separate trust and there will be no pooling of interests of property to which the trust relates'.*

[2] Paragraph 20 of PR 2005/96 provides that the '*… Investors may be individuals, companies, trusts or superannuation funds*'.

Product Ruling PR 2005/40 entitled *Income tax: tax consequences of investing in Macquarie Regular Instalment Warrants IMF Series 2004 Product Disclosure Statement - cash applicants and on-market purchasers* (withdrawn) ('**PR 2005/40'**) discusses the relationships and obligations that arise under that specific product. It is observed at paragraph 16(d) of PR 2005/40 that:

> '*… under a Cash Application, the Cash Applicant* … [e.g. a trustee of a superannuation fund] *… pays the varying First Payment …* [i.e. the initial 'instalment']. *Macquarie …* [i.e. the financier] *… lends the Completion Payment amount (which is the current Loan Amount) to the Cash Applicant and takes a security interest over the Underlying Share …* [i.e. the asset to be held subject to the warrant arrangement] *… . Proceeds of the Loan and the First Payment from the Cash Applicant are applied toward the purchase of the Underlying Share, prepayment of interest to Macquarie and the payment of borrowing fees to Macquarie. Macquarie buys the underlying share in the name of the Security Trustee* [i.e. the '*bare'* trustee in the warrant relationship]. *The Macquarie IMF instalment is issued in the name of the cash Applicant.'*

Sub-paragraph 16(f) of PR 2005/40 provides that:

> *'… repayment of the Loan will be secured by a mortgage over the Underlying Share which will be held by the Security Trustee as trustee for the Holder. Each trust and each Underlying Share to which it relates will be kept as a separate trust and there will be no pooling of interests or property to which the trust relates.'*

The 'Loan' in the warrant arrangement described in PR 2005/40 is described in paragraph 16(g):

> *'the Loan is provided on a limited recourse basis such that Macquarie's right to repayment of the Loan is limited to the amount it can obtain by enforcing its right in respect of the Mortgaged Property'.*

Product Ruling PR 2006/5 entitled *Income tax: tax consequences of investing in Westpac 'SWB' Series Self-Funding Instalments - 2005 Product Disclosure Statement - cash applicants and on-market purchasers (withdrawn)* ('**PR 2006/5'**)[3] is another example. Paragraphs 16 to 18 of PR 2006/5 describe the participants involved in the product:

> *'16. Westpac …* [i.e. the financier] *… is the Issuer of the Westpac SWB Instalments and is also the provider of the Loans to Holders …* [e.g. a trustee of a superannuation fund] *… to fund the acquisition of the Underlying Parcel …* [i.e. asset to be held subject to the warrant relationship].
>
> *17. Westpac Custodian Nominees Limited* ... [i.e. the 'bare' trustee in the warrant relationship] *…, as Security Trustee, holds the legal title to each Underlying Parcel for each Holder.*
>
> *18. The Holders may be individuals, companies, trusts or superannuation funds'.*

Sub-paragraph 15(a) of PR 2006/5:

> *'Westpac SWB Instalments …* [i.e. the warrant] *… are a leveraged investment under which a Holder …* [e.g. a trustee of a superannuation fund] *… acquires a beneficial interest in shares and/or stapled securities listed on the ASX and/or units in certain listed trusts (Security) …* [i.e. asset to be held subject to the warrant relationship] *… using a limited recourse Loan made by Westpac …* [i.e. the financier]. *Where the Security includes a stapled security, the stapled security comprises shares and/or units that are jointly listed for quotation on the ASX. The Security, together with any Accretions, is referred to as the 'Underlying Parcel'.*

[3] Paragraph 18 of PR 2006/5 provides that the '… Holders may be individuals, companies, trusts or superannuation funds'.

Sub-paragraph 15(g) of PR 2006/5:

> *'… repayment of the Loan is secured by a mortgage over the Underlying Parcel. Legal title to the Underlying Parcel is held by the Security Trustee* ... [i.e. the 'bare' trustee in the warrant relationship] *… on trust for the Holder. Each Underlying Parcel is held on a Separate Trust and there is no pooling of interests or property to which the trust relates …'.*

Subparagraph 15(i) of PR 2006/5:

> *'… the Loan is provided on a limited recourse basis so that if the Holder does not make the Completion Payment, Westpac's right to repayment is limited to the proceeds which it can obtain from enforcing its Security Interest over the Underlying Parcel. If the Holder provides a Completion Notice to Westpac, however, Westpac is entitled to recover the Completion Payment from the Holder in full …'.*

3 Estate planning and superannuation

A member's interest in a superannuation fund does not automatically form part of their estate. However, in the context of estate planning and superannuation, there are a number of considerations, including:

- when benefits must be paid;
- who can receive the benefits;
- in what form should those benefits be taken; and
- the taxation implications for the beneficiaries.

3.1 What is a 'death benefit'?

Regulation 6.21 of the SIS Regulations provides that a trustee of a regulated superannuation fund is required to cash a member's benefit as soon as practicable after a member's death. Except if there is an effective death benefit nomination, the superannuation fund's trustee has a discretion as to which dependants it should distribute a deceased's benefits.

The term 'superannuation death benefit' is defined in section 307-5 of the 1997 Act. Amongst other things, item 1 of column 3 in that section defines a 'superannuation death benefit as '*A payment to you from a superannuation fund, after another person's death, because the other person was a fund member.*'

Section 307-10 of the 1997 Act sets out the payments which are not considered 'superannuation death benefits'.

3.2 Payment of death benefits

A payment from a superannuation fund in consequence of the death or a member can be paid either:

1. directly to a beneficiary; or
2. to the executor of the deceased's estate or a trustee of a testamentary trust, with the amounts then paid to a beneficiary as a distribution from the estate or the trust.

Broadly speaking, upon death a member's superannuation interest is transferred from the member's fund, being a 'death benefit'. Subject to the terms of the particular trust deed of the superannuation fund, the transfer may be effected by either a lump sum payment, an income stream, or both.

Regulation 6.21(2) of the SIS Regulations provides that a lump sum must not be paid in more than two instalments.

Further, there are limitations with respect to the payment of income streams.

3.3 Timing of payment of death benefits

Regulation 6.21(1) of the SIS Regulations provides that '*… a member's benefits in a regulated superannuation fund must be cashed as soon as practicable after the member dies.*' That is, there is no prescribed time in which a death benefit must be paid. All that is required is that the payment must be made as soon as practicable after death.

3.4 Lump sum payments

Section 302-60 of the 1997 Act provides that lump sum payments received by a dependant of the deceased is tax free. The amount is treated as non-assessable non-exempt income.

However, if a lump sum is paid to a non-dependant, then the tax free component will not be subject to tax (see section 302-140 of the 1997 Act), but the taxable component of the lump sum is included in the recipient's assessable income and subject to tax at marginal rates. Section 302-145 of the 1997 Act provides for a tax offset mechanism, that ensures that the rate of tax on the tax free component does not exceed 30% (plus Medicare levy), whereas the rate of tax on the tax free component does not exceed 15% (plus Medicare levy).

Superannuation lump sum death benefit	Dependent	Non-dependent	
		Taxed element	Untaxed element
Tax free component	Tax free	Tax free	Tax free
Taxable component	Tax free	15%	30%

The possible methods of transfer of a member's interest upon death depend on the character of the recipient, with the possibilities being:

Recipient	Permitted benefit
Spouse	Either or both a lump sum and/or income stream
Dependent children under the age of 18	Either or both a lump sum and/or income stream. However, income stream must cease at 25.
Non-dependent children over the age of 18	Lump sum
Dependent children between 18 and 25	Either or both a lump sum and/or income stream.

	However, income stream must cease at 25.
Dependent child over the age of 25	Lump sum
Dependent grandchildren	Either or both a lump sum and/or income stream
Non-dependent grandchildren	Lump sum (made via estate)
Non-dependent (i.e. not child or spouse)	Lump sum (made via the estate)
Estate	Lump sum

3.5 Income streams

Section 302-65 of the 1997 Act provides that a superannuation income stream is tax free if either the deceased or the dependant is aged at least 60 as at the time of death.

If a superannuation income stream is paid to a dependant upon death, and neither the deceased or the dependant are aged at least 60 at the time of death, then:

- that part of the income stream which is the ***tax free component*** is tax free;
- that part of the income stream which is paid from a ***taxed component*** is assessable income for the dependent. The dependent is entitled to a tax offset which is equal to 15% of the element taxed in the fund. The income stream becomes tax free when the recipient turns 60 years of age;
- that part of the income stream which is paid from an ***untaxed component*** is assessable income for the dependent. The dependent will receive a tax offset of only 10%, but only when they attain the age of 60.

A non-dependent is unable to receive a superannuation income stream. Such income streams must be commuted, and paid to the non-dependant as a lump sum.

3.6 Who is a dependent?

The term 'dependent' for taxation purposes is defined in section 302-195 of the 1997 Act. Subsection 302-195 of the 1997 Act provides that:

*'(1) A **death benefits dependant**, of a person who has died, is:*

(a) the deceased person's spouse or former spouse; or

(b) the deceased person's child, aged less than 18; or

(c) any other person with whom the deceased person had an interdependency relationship under section 302-200 just before he or she died; or

(d) any other person who was a dependant of the deceased person just before he or she died. '

That is, a 'death benefit dependant' with respect to a deceased includes:

- the deceased's spouse;
- the deceased's former spouse;
- the deceased's child, provided that at the time of death the child is under the age of 18;
- a person with whom the deceased had an 'interdependency relationship' just before the deceased died;
- any other person who was a 'dependant' of the deceased just before the death of the deceased; and
- under section 302-195 of the 1997 Act, a death benefits dependant also includes a person who receives a superannuation pension or annuity if the annuity or pension commenced before 1 July 2007 as a result of the death of another person.

3.7 Interdependency relationship

The term 'interdependency relationship' for the purposes of paragraph 302-195(1)(c) of the 1997 Act is provided for in section 302-200 of the 1997 Act:

'What is an interdependency relationship?

*(1) Two persons (whether or not related by family) have an **interdependency relationship** under this section if:*

(a) they have a close personal relationship; and

(b) they live together; and

(c) one or each of them provides the other with financial support; and

(d) one or each of them provides the other with domestic support and personal care.

*(2) In addition, 2 persons (whether or not related by family) also have an **interdependency relationship** under this section if:*

(a) they have a close personal relationship; and

(b) they do not satisfy one or more of the requirements of an interdependency relationship mentioned in paragraphs (1)(b), (c) and (d); and

(c) the reason they do not satisfy those requirements is that either or both of them suffer from a physical, intellectual or psychiatric disability.

(3) The regulations may specify:

*(a) matters that are, or are not, to be taken into account in determining under subsection (1) or (2) whether 2 persons have an **interdependency relationship** under this section; and*

*(b) circumstances in which 2 persons have, or do not have, an **interdependency relationship** under this section.'*

That is, two individuals have an independency relationship if they satisfy ***all*** of the following conditions (see section 302-200 of the 1997 Act):

- they have a close personal relationship;
- they live together;
- one or each of them provides the other with financial support; and
- one or each of them provides the other with domestic support and personal care.

3.8 Life insurance and superannuation funds

An important part of a financial plan is life insurance. Generally speaking, a life insurance payout can:

1. form part of the deceased's estate;
2. be directed to a specific beneficiary; or
3. be paid to the policy owner.

The purpose of life insurance is to provide a lump sum benefit upon death of the life insurer. Life insurance which is 'term insurance' is guaranteed to be renewable (i.e. the policy cannot be changed) whilst the premiums continue to be paid. Such a policy can be held within a superannuation fund, with the result that upon death of the individual insured, the proceeds are paid to the fund. This has the result of increasing the death benefit payable.

Upon death, the proceeds of life insurance policies held by the superannuation fund are paid directly to the fund (as the policy owner). The proceeds are allocated to the member's fund as a taxable component.

The death benefit is paid tax free as a lump sum to a death benefit dependent. However, such a payment made to a non-financial dependant will be taxable (with no low rate threshold for the taxable component.

The taxable component paid from insurance proceeds may be either a taxed component or an untaxed component. A higher rate of tax is payable on an untaxed component received by a non-death benefit dependent. If:

- the superannuation fund **has not** claimed a tax deduction for the premiums paid for the insurance policy, then the ***taxable component*** is a ***taxed component***; and
- the superannuation fund **has** claimed a tax deduction for the premiums paid for the insurance policy, then the ***taxable component*** is an ***untaxed component***.

Further, in the year that a death benefit is made, the trustee can choose to claim a deduction for the future service period of that member instead of claiming a tax deduction for the premium paid on the insurance policy. This strategy will only be beneficial if the fund is in accumulation (i.e. tax paying) phase, and not income phase.

3.9 Binding nominations in the context of self-managed superannuation fund

Section 59 of the SIS Act provides that:

'(1) Subject to subsection (1A), the governing rules of a superannuation entity other than a self managed superannuation fund must not permit a discretion under those rules that is exercisable by a person other than a trustee of the entity to be exercised unless:

(a) those rules require the consent of the trustee, or the trustees, of the entity to the exercise of that discretion; or

(b) if the entity is an employer-sponsored fund:

(i) the exercise of the discretion relates to the contributions that an employer-sponsor will, after the discretion is exercised, be required or permitted to pay to the fund; or

(ii) the exercise of the discretion relates solely to a decision to terminate the fund; or

(iii) the circumstances in which the discretion was exercised are covered by regulations made for the purposes of this subparagraph.

(1A) Despite subsection (1), the governing rules of a superannuation entity may, subject to a trustee of the entity complying with any conditions contained in the regulations, permit a member of the entity, by notice given to a trustee of the entity in accordance with the regulations, to require a trustee of the entity to provide any benefits in respect of the member on or after the member's death to a person or persons mentioned in the notice, being the legal personal representative or a dependant or dependants of the member.

(2) If the governing rules of a superannuation entity are inconsistent with subsection (1), that subsection prevails, and the governing rules are, to the extent of the inconsistency, invalid.'

Further, section 31 of the SIS Act provides that regulations may be made so as to provide operating standards for superannuation fund. Relevantly, Regulation 6.17A of the *Superannuation Industry (Supervision) Regulations 1993* (Cth) provides that:

'6.17A Payment of benefit on or after death of member
(Act, s 59 (1A))

(1) For subsections 31(1) and 32(1) of the Act, the standard set out in subregulation (4) is applicable to the operation of regulated superannuation funds and approved deposit funds.

(2) For subsection 59(1A) of the Act, the governing rules of a fund may permit a member of the fund to require the trustee to provide any benefits in respect of the member, on or after the death of the member, to the legal personal representative or a dependant of the member if the trustee gives to the member information under subregulation (3).

(3) The trustee must give to the member information that the trustee reasonably believes the member reasonably needs for the purpose of understanding the right of that member to require the trustee to provide the benefits.

(4) Subject to subregulation (4A), and regulations 6.17B, 7A.17 and 7A.18, if the governing rules of a fund permit a member of the fund to require the trustee to provide any benefits in accordance with subregulation (2), the trustee must pay a benefit in respect of the member, on or after the death of the member, to the person or persons mentioned in a notice given to the trustee by the member if:

(a) the person, or each of the persons, mentioned in the notice is the legal personal representative or a dependant of the member; and

(b) the proportion of the benefit that will be paid to that person, or to each of those persons, is certain or readily ascertainable from the notice; and

(c) the notice is in accordance with subregulation (6); and

(d) the notice is in effect.

(4A) The trustee is not required to comply with subregulation (4) if the trustee:

(a) is subject to a court order that has the effect of restraining or prohibiting the trustee from paying a benefit in respect of the member in accordance with a notice of the kind described in that subregulation; or

(b) is aware that the member of the fund is subject to a court order that:

(i) requires the member to amend or revoke a notice of that kind that the member has given the trustee; or

(ii) has the effect of restraining or prohibiting the member from giving a notice of that kind.

(5) A member who gives notice under subregulation (4) may:

(a) confirm the notice by giving to the trustee a written notice, signed, and dated, by the member, to that effect; or

(b) amend, or revoke, the notice by giving to the trustee notice, in accordance with subregulation (6), of the amendment or revocation.

(6) For paragraphs (4) (c) and (5) (b), the notice:

(a) must be in writing; and

(b) must be signed, and dated, by the member in the presence of 2 witnesses, being persons:

(i) each of whom has turned 18; and

(ii) neither of whom is a person mentioned in the notice; and

(c) must contain a declaration signed, and dated, by the witnesses stating that the notice was signed by the member in their presence.

(7) Unless sooner revoked by the member, a notice under subregulation (4) ceases to have effect:

(a) at the end of the period of 3 years after the day it was first signed, or last confirmed or amended, by the member; or

(b) if the governing rules of the fund fix a shorter period — at the end of that period.'

However, in Self Managed Superannuation Funds SMSFD 2008/3, entitled *Self Managed Superannuation Funds: is there any restriction in the Superannuation Industry (Supervision) legislation on a self managed superannuation fund trustee accepting from a member a binding nomination of the recipients of any benefits payable in the event of the member's death?*, the Commissioner of Taxation observed that:

> *'Section 59 of the Superannuation Industry (Supervision) Act 1993 (SISA) and regulation 6.17A of the Superannuation Industry (Supervision) Regulations 1994 (SISR) do not apply to self managed superannuation funds (SMSFs). This means that the governing rules of an SMSF may permit members to make death benefit nominations that are binding on the trustee, whether or not in circumstances that accord with the rules in regulation 6.17A of the SISR.*
>
> *2. However, a death benefit nomination is not binding on the trustee to the extent that it nominates a person who cannot receive a benefit in accordance with the operating standards in the SISR. The relevant operating standards are mentioned in Appendix 1 of this Determination.'*

As a result, before a death benefit nomination is made, regard should be given to the particular constituent documents for the fund so as to determine what (if any) death benefit nominations can be made. In the event that the constituent documents are silent on the matter, then no nomination can be made.

Further, if the constituent documents provide that binding death benefit nominations may be made under the SIS Act, and because the relevant binding death benefit rules in the SIS Act do not apply to self-managed superannuation funds, such a provision will not allow a member to make such nominations.

It should be noted that the jurisdiction of the Superannuation Complaints Tribunal does not extend to decisions made by trustees of self-managed superannuation funds or certain public sector superannuation schemes. As a result, self-managed superannuation funds are a valuable mechanism to ensure that a death benefit is paid as directed by the deceased member.

Further, because death benefits are not dealt with under a will, legal challenges can be greatly reduced by directing payments from a self-managed superannuation fund upon death directly to a person specified by the deceased, as opposed to having such payments directed to the estate of the deceased.

However, it should also be noted that if the decision as to who will receive the death benefit is made by the remaining trustee(s) of the self-managed superannuation fund, the death benefit may be paid in a way which is contrary to the deceased member's wishes. Consideration should be given to the decision in *Katz v Grossman* [2005] NSWSC 934, which according to the first sentence of the judgement was: '*…a contest between a brother and a sister over the control of a superannuation trust fund established at the behest of their late father Ervin Katz. The assets of the fund exceed $1 million.*'

Katz v Grossman is authority for the proposition that in the event that binding directions are not provided to the trustee of a self-managed superannuation fund, then the trustee of a fund has complete discretion with respect to dealings with superannuation benefits. Such discretion includes the trustee providing the benefits to themselves, notwithstanding that they are not dependants of the deceased.

Ervin Katz was a member of the E. Katz Employees Trust Fund, which was a self-managed superannuation fund. Both Mr Katz and his daughter, Linda Ann Grossman were trustees of the self-managed superannuation fund. Mr Katz had made a non-binding nomination, in which he expressed the desire for his death benefit to be divided equally amongst his daughter (the co-trustee) and his son.

However, following the death of Mr Katz, Mrs Grossman appointed her husband as a co-trustee. The trustees then resolved to pay the whole of Mr Katz's death benefit to Mrs Grossman.

Mr Katz's son took action in the New South Wales Supreme Court arguing that:

- Mr Katz had not validly appointed Mrs Grossman as a trustee; and that
- Mrs Grossman was not validly appointed as a member.

With respect to the first issue, after reviewing the terms of the superannuation fund's deed, the relevant documentation and consideration of the *Trustee Act 1925* (NSW) , Smart AJ held that Ms Grossman had been validly appointed. As a result, Mrs Grossman's decisions were held to be valid, which included the payment of the death benefit referable to Mr Katz's interest in the fund to herself.

With respect to the issue of whether Mrs Grossman was validly appointed as a member of the fund, Smart AJ considered that because the fund's deed required an appointment as a member to be effective the trustee had to consent to it, as there was no documentary evidence which showed that the trustee had consented to Mrs Grossman becoming a member, it was held that Mrs Grossman was not a member of the fund.

As a result, in order to ensure that the wishes of a member with respect to the payment of their interest in a self-managed superannuation fund occurs, either a binding death benefit nomination should be executed, or there should be a trust deed direction which provides for such wishes.

3.10 Superannuation proceeds trusts

Division 6AA of the 1936 Act discourages 'income splitting' by means of diversion of income to children to take advantage of the tax-free threshold and progressive tax rates. Broadly speaking, the provisions apply a 45% tax rate on unearned income of minors. Such income includes certain distributions from trusts.

However, Division 6AA of the 1936 Act does not apply to certain 'excepted trust income'. Such trust income includes that from a 'superannuation proceeds trust'. That is, superannuation proceeds trusts may be established by the transfer of property from a superannuation fund, as a result of the death of a person, to a trustee of a trust which will hold the property for the benefit of a child.

Paragraph 102AG(2)(c)(v) of the 1936 Act provides that:

> *'(2) Subject to this section, an amount included in the assessable income of a trust estate is excepted trust income in relation to a beneficiary of the trust estate to the extent to which the amount:*

> …
>
> *(c) is derived by the trustee of the trust estate from the investment of any property transferred to the trustee for the benefit of the beneficiary:*
>
> *...*
>
> *(v) directly as the result of the death of a person and out of a provident, benefit, superannuation or retirement fund;'*

The terms of the trust must provide for the beneficial acquisition of trust property by the beneficiary upon the termination of the trust.

Although death benefits do not generally form part of an estate, generally speaking, superannuation proceeds trusts are established under the terms of a will. Such a transfer may be ensured via a binding death benefit nomination.

The Commissioner in ATO ID 2001/751 accepts even where a superannuation death benefit is paid to a trustee, apart from the estate (e.g. so as to satisfy the superannuation cashing rules, to an adult child of the deceased), in order to assess whether the superannuation death benefit tax concessions apply, one should look through the trust to the underlying beneficial ownership of the trust.

This would be the situation if the beneficiaries of such a trust were minor children of the deceased.

4 Stamp duty

4.1 Corporate reconstruction exemption

The Duties Act imposes duty on a transfer of dutiable property, which includes a business asset in New South Wales that is goodwill, intellectual property or a statutory licence or permission. However, the Duties Act provides an exemption for certain transactions between the members of a group of corporations.

Specifically, section 281 of the Duties Act provides that duty is not chargeable on a corporate reconstruction transaction approved by the Chief Commissioner in accordance with guidelines approved by the Treasurer. A 'corporate reconstruction transaction' includes, amongst other things, a transfer or agreement for the sale or transfer, of dutiable property between corporations that are members of the same group.

In Revenue Ruling DUT 26, the Chief Commissioner sets out the applicable guidelines for granting exemptions to corporate reconstruction transactions effected on or after 1 January 2004. In order for the guidelines to apply, there must be eligible transactions as specified in the guidelines. Relevantly, a transfer of dutiable property between members of a corporate group is an eligible transaction to which the guidelines apply. A corporate group is defined in the guidelines to mean a parent corporation and its subsidiary where the parent corporation directly owns (other than as trustee) at least 90% of issued shares and voting power. Further, the transaction must not be an ineligible transaction, that is:

- the property the subject of the transaction must not be trust property immediately before or immediately after the transaction;

- the relevant members of the corporate group in the transaction must be members of that group for at least 12 months before the transaction, unless the dutiable property was acquired by the transferor after it became a member of the corporate group;
- the transaction must not be made under an arrangement under which:
    - part or all of the consideration for the transaction has been or will be provided or received, directly or indirectly, by a person other than a member of the corporate group; or
    - a member of the corporate group is to be enabled to provide any of the consideration by another person, other than:
        - by a financial institution by way of loan on ordinary commercial terms, or
        - by another member of the corporate group, or
        - under an offer and sale or issue of shares or units to the public in the circumstances mentioned in paragraph (11)(b) in the guidelines (which relates to the offer, sale or issue of shares for the purposes of listing a company on the Australian Stock Exchange).

The exemption is available to a transaction to which the guidelines apply so that duty is not chargeable on the transaction if the Chief Commissioner is satisfied that:

- the transaction is, or is one of a series of transactions, undertaken for the purpose of changing a corporate structure to make internal adjustments to corporate arrangements, or changing the holding of assets within the corporate group, or both, and
- the transaction or each transaction is necessary to give effect to that purpose, and is not undertaken for a purpose of avoiding any Commonwealth, State or Territory taxation, and
- the transaction is not part of an arrangement under which any corporation involved with any of the transactions ceases to belong to the same corporate group other than in certain limited circumstances outlined below.

A written application for the exemption is to be made to the Chief Commissioner and must contain a written undertaking to notify the Chief Commissioner if any parties to the relevant transaction cease to remain a member of the corporate group except in the circumstances outlined below. The application may be made at any time prior to the relevant transaction or within 5 years of the date of assessment of the transaction.

Approval by the Chief Commissioner of the corporate reconstruction exemption is conditional on every party to the transaction remaining a member of the corporate group for 12 months after the transaction, subject to the following exceptions:

- a corporation ceases to be a member of the corporate group because it ceases to exist, other than under an arrangement, a significant purpose of which was to avoid the condition imposed on the exemption; or

- the transaction is part of an arrangement under which shares or units of the corporation, or shares or units of a parent corporation, are offered and sold or issued to the public for the purpose of listing the corporation on the Australian Stock Exchange, and the shares or units are quoted within 12 months after the offer to the public.

Failure to satisfy the condition for the exemption would cause the Chief Commissioner to reassess the stamp duty on the transaction.

4.2 Superannuation and Stamp Duties

Consideration should also be given to the stamp duty exemption in relation to superannuation funds under the Duties Act in relation to business real property.

4.2.1 Transfer as a result of change in superannuation membership

Section 61 of the Duties Act provides for an exemption in respect of transfers of property in connection with persons changing superannuation fund. On application of the exemption, the duty chargeable on a relevant transfer is ad valorem duty or $500, whichever is the lesser (see subsection 61(2)).

Relevantly, subsection 61(1) of the Duties Act provides:

> *'(1) This section applies to a relevant transfer that occurs in connection with a person:*
>
> *(a) ceasing to be a member of, or otherwise ceasing to be entitled to benefits in respect of, a superannuation fund that is a complying superannuation fund or was a complying superannuation fund within the period of 12 months before the transfer was made, and*
>
> *(b) becoming a member of, or otherwise becoming entitled to benefits in respect of, another superannuation fund that is also a complying superannuation fund or will, in the opinion of the trustees of both funds concerned, be a complying superannuation fund within 12 months after the transfer is made.'*

A 'relevant transfer' is set out in subsection 62(1A) to be:

> *'(a) a transfer of, or an agreement to transfer, dutiable property from a trustee of a superannuation fund, or a custodian of the trustee, to the trustee of another superannuation fund, or to a custodian of the trustee of another superannuation fund,*
>
> *(b) a transfer of, or an agreement to transfer, dutiable property from a trustee of a superannuation fund to a custodian of the trustee, or from a custodian of the trustee of a superannuation fund to the trustee,*
>
> *(c) a transfer of, or an agreement to transfer, marketable securities from a trustee of a pooled superannuation trust, made in exchange for a redemption of units in the trust, to the trustee of a superannuation fund, or a custodian of the trustee of a superannuation fund,*
>
> *(c1) a transfer of, or an agreement to transfer, marketable securities from the trustee of a superannuation fund, or a custodian of the trustee of a superannuation fund, made in exchange for the issue of units in a pooled superannuation trust, to a trustee of the pooled superannuation trust,*

(d) a transfer of, or an agreement to transfer, marketable securities from a life company or custodian for a life company to the trustee of a superannuation fund or a custodian of the trustee of a superannuation fund if the transfer is made in consideration of the surrender or termination, by the trustee of the superannuation fund of which the person has ceased to be a member, of a policy of life insurance issued by the life company.'

It is noted that the exemption in section 61 is available to complying superannuation funds whilst the exemption in section 62A is only available to self managed superannuation funds.

4.2.2 Transfer to a self managed superannuation fund

Section 62A of the Duties Act provides for nominal duty to be paid on a transfer to the trustee or the custodian of the trustee of a self-managed superannuation fund ('**SMSF**'):

'62A Transfers to self managed superannuation funds

(1) Duty of $50 is chargeable on a transfer of, or an agreement to transfer, dutiable property from a person (the transferor) to the trustee of a self managed superannuation fund but only if:

(a) the transferor is the only member of the superannuation fund or the property is to be held by the trustee solely for the benefit of the transferor, and

(b) the property is to be used solely for the purpose of providing a retirement benefit to the transferor.

(2) Property held by the trustee of a superannuation fund is held solely for the benefit of the transferor if:

(a) the property is held specifically for the benefit of the transferor, as a member of the superannuation fund, and

(b) the property (or proceeds of sale of the property) cannot be pooled with property held for another member of the superannuation fund, and

(c) no other member of the superannuation fund can obtain an interest in the property (or the proceeds of sale of the property).

(3) Duty of $500 is chargeable on a transfer of, or an agreement to transfer, dutiable property from a person (the ***transferor****) to the custodian of the trustee of a self managed superannuation fund but only if:*

(a) the transferor is the only member of the superannuation fund, or

(b) the property is to be used solely for the purpose of providing a retirement benefit to the transferor.

(4) This section does not apply in respect of a transfer of, or an agreement to transfer, dutiable property if, as a result of the transfer, the superannuation fund will cease to be a complying superannuation fund.'

In particular, subsection 62A(3) was inserted by the *State Revenue Legislation Further* Amendment *Act* 2010 (NSW) which had effect from 1 January 2011.

The insertion of subsection 62A(3) means that a person may transfer NSW dutiable property to the custodian of a SMSF if the transferor is the only member of the fund, or the property is to be used solely for the purpose of providing a retirement benefit to the transferor (see also subsection 62A(2)).

The property could then be held on a gearing arrangement pursuant to section 67A of the SIS Act. Section 67A of the SIS Act requires that the legal title of the property is to be held on trust so that the trustee of the SMSF acquires a beneficial interest in the property. As a result, and pursuant to both section 67A of the SIS Act and the security trust, the registered proprietor of the property (and therefore the 'transferee' disclosed on the transfer) will be the bare trustee / custodian.

The security trust deed will be subject to nominal ($50) duty pursuant to subsection 55(1) of the Duties Act, which provides that:

> *'Duty of $50 is chargeable in respect of:*
>
> *(a) a declaration of trust made by an apparent purchaser in respect of indentified dutiable property:*
>
> *(i) vested in the apparent purchaser upon trust for the real purchaser who provided the money for the purchase of the dutiable property, or*
>
> *(ii) to be vested in the apparent purchaser upon trust for the real purchaser, if the Chief Commissioner is satisfied that the money for the purchaser of the dutiable property has or will be provided by the real purchaser ...'*

Paragraph 55(1A) of the Duties Act further provides that:

> *'For the purposes of subsection (1), money provided by a person other than the real purchaser is taken to have been provided by the real purchaser if the Chief Commissioner is satisfied that the money was provided as a loan and has or will be repaid by the real purchaser.'*

That is, under the gearing arrangement, the mere registered proprietor / bare trustee / custodian (i.e., the 'apparent purchaser' pursuant to section 55 of the Duties Act) of the property will hold the property for the 'real purchaser', being the SMSF trustee.

4.2.3 Transfer of property to trustees or custodians of superannuation funds

Section 62 of the Duties Act provides an exemption for a transfer or an agreement to transfer dutiable property between trustees and custodians of superannuation funds or pooled superannuation trusts where there is no change in the beneficial ownership of the property.

On application of the exemption, the duty chargeable on a dutiable transaction is ad valorem duty or $500, whichever is the lesser (see subsection 62(3)), or if the transfer relates to marketable securities, the duty of $10.

Trusts

5 Restructuring Inter Vivos Trusts

Trust '**cloning**' or '**replication**'[4] and trust '**splitting**' are currently very popular mechanisms for family succession planning. Ostensibly they are quite straightforward. However, there are significant tax and trust law traps for the unwary.

For the purposes of this paper:

- '**splitting**' means maintaining the one trust relationship but appointing separate trustees for different assets of that one trust. The trust obligations are undertaken according to the trust relationship spelled out in the trust deed establishing the trust;

- '**cloning**' involves the establishment of a new trust relationship in respect of assets held by the trustee. That trust relationship may come about by settling the asset on the new trustee or bringing into existence a new trust relationship and transferring the asset to the trustee of that new trust relationship.

Although trust cloning has been a popular mechanism for the purposes of succession planning in the context of discretionary trusts given the (perceived) availability of exemptions from capital gains tax (more particularly, exemptions from CGT events E1 and E2), Press Release No. 092 of the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs (dated 31 October 2008) announced the abolition of the possible exemption.

However, it should be noted that the *Tax Laws Amendment (2009 Measures No. 6) Bill 2009* (Cth) ('**the TLAB6**') which was introduced to the House of Representatives on 25 November 2009, was passed by the Senate on 11 March 2010 and received royal asset on 24 March 2010. The TLAB6 amends the 1997 Act by removing the capital gains tax trust cloning exception and providing a limited CGT roll-over where assets are transferred between fixed trusts (i.e. unit trust) that have the same beneficiaries with the same entitlements and no material discretionary elements. The roll-over would have effect on or after 1 November 2008.

It is therefore expected that splitting will probably be the preferred method of ensuring the effective passing of control of trusts between generations.

5.1 Why split or clone?

During the latter part of the 20th century and early 21st century the use of trusts and, in particular, family discretionary trusts, has proliferated. Tax laws have to an extent driven small to medium business operators away from using corporate vehicles as such.[5] However, very often the second or third generations are left with trust structures that do not provide appropriate family succession outcomes.

Some of the things that lead to this conclusion are:

[4] The term '**cloning**' will be used in this paper.

[5] The overwhelming factor in selecting a discretionary trust (or unit trust) structure rather than a corporate structure is the availability of the 50% CGT discount where the business assets are sold rather than the ownership interests in the entity. A capital gain made by a company in its own right is not a discount capital gain: section 115-10 1997 Act.

- the family members may be incapable of making joint decisions;
- family members may vary greatly in business acumen, intellect, risk adversity and time opportunities;
- second and third marriages can lead to imperfectly blended families;
- family members will often have different financial needs eg. accumulation vs. present consumption;
- it may be desirable to separate assets to more fully protect some of them from potential creditors' claims.

The splitting and cloning approaches are generally played out in the context of the one family relationship. Overwhelmingly discretionary trusts are established for the one family, the members of which may wish to go their separate ways (for the reasons discussed above). On rare occasions a discretionary trust is established for separate family groups (it is ill advised to do so) and splitting or cloning may have application. However, if family trust elections have been made (or interposed entity elections are required to be made) the transactions become problematical. The writer's experience has been that splitting and cloning of discretionary trusts is inevitably about single-family relationships but often with the added complexity of children from multiple marriages who owe allegiances to different parts of the family.

Unit trusts are commonly used for business (or investment) joint ventures by unrelated family groups. Cloning or splitting unit trusts have their own unique issues in this context and these are addressed briefly below.

Cloning and splitting hybrid style trusts also have their own unique problems. Often such hybrid trusts will involve members of completely different families. These issues are also considered but briefly in this paper.

5.2 Splitting – The Drivers

Splitting in the way described above rather than cloning is very often driven by stamp duty outcomes. It delivers imperfect separation of control and financial exposure for family members. Why stamp duty? The stamp duties legislation in all jurisdictions will exempt (or impose nominal duty only) on the replacement of a trustee, addition of a trustee or retirement of a trustee.

In the Australian Capital Territory, subsection 54(2) of the *Duties Act 1999* (ACT) provides:

> *'(2) Duty of $20 is chargeable in respect of a transfer of dutiable property to a person as a consequence of the retirement of a trustee or the appointment of a new trustee, if the Commissioner is satisfied that, as the case may be –*
>
> *(a) except for a responsible entity of a managed investment scheme—none of the continuing trustees remaining after the retirement of a trustee is or can become a beneficiary under the trust; and*

> (b) *except for a responsible entity of a managed investment scheme—none of the trustees of the trust after the appointment of a new trustee is or can become a beneficiary under the trust; and*
>
> (c) *except if a responsible entity of a managed investment scheme acquires a beneficial interest in the managed investment scheme solely as a consequence of its appointment as the responsible entity—the transfer is not part of a scheme for conferring an interest, in relation to the trust property, on a new trustee or any other person, whether as a beneficiary or otherwise, to the detriment of the beneficial interest or potential beneficial interest of any person; and*
>
> (d) *the transfer is not made in connection with a tax avoidance scheme;*
>
> *and, if the Commissioner is not so satisfied, the transfer is chargeable with the same duty as a transfer to a beneficiary under and in conformity with the trusts subject to which the property is held.'*

In New South Wales subsection 54(3) of the *Duties Act 1997* (NSW) provides:

> *'Duty of $50 is chargeable in respect of a transfer of dutiable property to a person other than a special trustee as a consequence of the retirement of a trustee or the appointment of a new trustee, if the Chief Commissioner is satisfied that, as the case may be:*
>
> (a) *none of the continuing trustees remaining after the retirement of a trustee is or can become a beneficiary under the trust; and*
>
> (b) *none of the trustees of the trust after the appointment of a new trustee is or can become a beneficiary under the trust; and*
>
> (c) *the transfer is not a part of a scheme for conferring an interest in relation to the trust property, on a new trustee or any other person, whether as a beneficiary or otherwise, to the detriment of the beneficial interest or potential beneficial interest of any person.*
>
> *If the Chief Commissioner is not so satisfied, the transfer is chargeable with the same duty as a transfer to a beneficiary under and in conformity with the trusts subject to which the property is held, unless subsection 3A applies.'*[6]

Subsection 33(3) of the *Duties Act 2000* (Vic) provides that:

> *'No duty is chargeable under this Chapter in respect of a transfer of dutiable property to a person other than a special trustee if the Commissioner is satisfied that the transfer is made solely:*
>
> (a) *because of the retirement of a trustee or the appointment of a new trustee or other change in trustee; and*
>
> (b) *in order to vest the property in the trustee for the time being entitled to hold it.'*

In Queensland Section 117 of the *Duties Act 2001* (Qld) provides the exemption:

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[6] subsection 54(3A) is not relevant in the circumstances.

'Transfer duty is not imposed on a dutiable transaction for the sole purpose of giving effect to a change of trustee if:

(a) the transaction is not part of an arrangement:

(i) involving a change in the rights or interest of a beneficiary of the trust; or

(ii) terminating the trust; and

(b) transfer duty has been paid on all trust requisitions for which transfer duty is imposed for the trust before the transaction.'

These provisions contemplate nominal or no duty if the transfer of dutiable property is to give effect to the retirement of a trustee or the appointment of a new trustee. Both provisions require there to be no conferring of an interest in the trust property on the new trustee or any other person to the detriment of the beneficial interest or potential beneficial interest of any other person.

In Victoria the legislation is interpreted in a slightly different way in that under subsection 33(3) of the *Duties Act 2000* (Vic) the Commissioner must be satisfied that the transfer is made solely because of the appointment of a new trustee and in order to vest the property in the trustee.[7] In Revenue Ruling DA030 the State Revenue Office suggests that the Commissioner will not be satisfied if the transfer forms part of a transaction or series of transactions that have a separate commercial objective whether or not the transaction has the effect of avoiding the payment of duty. It is not clear what is meant by 'a separate commercial objective'. A splitting of a family trust arrangement has no commercial objective. It is a family arrangement.

All of the other stamp duty legislations have provisions, which exclude transfers to effect a mere change of trustee.[8] Most of them have similar anti-avoidance aspects.

In a land rich context Australian Capital Territory,[9] New South Wales,[10] Victoria[11] and Queensland[12] exempt changes of trustees.

From a stamp duty perspective extreme care needs to be taken that the express words of the exemption are complied with. There is a view about that it is necessary to appoint a co-trustee in respect of all of the assets of the trust and then have the original trustee resign (and presumably the new trustee resign

[7] a '*new trustee*' is '*a trustee appointed in substitution for a trustee or trustees or a trustee appointed in addition to a trustee or trustees*': subsection 33(1) *Duties Act 2000* (Vic).

[8] NT — Item 6 in Schedule 2 *Stamp Duty Act*

TAS — section 37 *Duties Act 2001*

WA — paragraph 73AA(1)(a) *Stamp Act 1921*.

[9] Section 91 imposes a nominal duty to interests that are subject to landholder duty under Part 3.2 of the *Duties Act 1999* (ACT) that is acquired under section 54 (change in trustee).

[10] Land rich duty under Chapter 4 of the *Duties Act* 1997 (NSW) will not apply if the provisions of section 54 would have imposed nominal duty of $50 only: subsection 163A(f).

[11] Subsection 85(1) *Duties Act* 2000 (Vic) exempts the acquisition of an interest in a land rich entity if the transaction, had it taken place in relation to the underlying land, would have been exempt.

[12] Section 191 of the *Duties Act 2001* (Qld) excludes land rich duty if the relevant acquisition is for the sole purpose of giving effect to a change of trustee, if the acquisition is not part of an arrangement involving a change in the rights or interests of a beneficiary of the trust or terminating the trust, the acquisition is not part of an arrangement to avoid the imposition of duty and transfer duty has been paid on all trust acquisitions for which transfer duty is imposed for the trust before the acquisition.

in respect of those assets to be exclusively held by the old trustee) from their position in relation to those assets which are to be under the exclusive control of the new trustee. This is a reaction to the perceived disjunction between retirement of a trustee and appointment of a new trustee. This may be an over-reaction.

The requirement that the arrangements do not confer a benefit in relation to the trust property on the new trustee or any other person must be at least considered in the light of the decision of the High Court in *CPT Custodian.*[13] The High Court has made it plain that the trustee has an equitable interest in the trust property and the beneficiaries' interest is subject to the priority of that interest. When a new trustee is appointed that trustee obtains a right to be indemnified – '*the right of the trustee under the general law to reimbursement or exoneration for the discharge of liabilities incurred in the administration of the trust*'.[14]

If, as is commonplace, the old trustee assigns its right to be indemnified out of the trust assets the new trustee will obtain a benefit in relation to the trust property. However, the potential for that benefit to eliminate the exemption is itself excluded by the requirement that there be a detriment in relation to the beneficial interest of some other person. No beneficial interest, save that of the retiring trustee, is altered detrimentally by the acquisition by the new trustee of a claim in respect of the trust assets. The retiring trustee does not suffer a detriment because the claims against it must be reduced as a result of its retirement (or it has a right to be indemnified by the continuing trustee).

Ordinarily this should not pose a problem but, again, great care needs to be taken with respect to the precise requirements of the relevant provision.

5.3 Splitting – Is there a Resettlement?

This subject can be described in this way — can a transfer of assets to another trustee, but subject to the precise terms of the trust instrument, bring into existence a different trust relationship? The argument that this is a new trust derives out of the rationale that a trust is a personal relationship in regard to property subject of the trust instrument between the trustee, the settlor and the beneficiaries. It follows in this argument that, if there is a new trustee, there must be a new trust relationship. This approach emphasises the relationship between the parties as the hallmark of a trust. The alternative view is that the true character of a trust relationship is to be found in the nature of the beneficial entitlements and the identity of the trustee is irrelevant. The writer prefers this latter approach – an appointment of a new trustee in respect of particular assets of the trust but adhering to the terms and conditions is not a new trust relationship but a continuation of the old relationship. Whether or not there is a resettlement turns on the question whether there is an alteration to the substratum of the trust sufficient to constitute it a new trust relationship. The observations of Megarry J in *Re Ball's Settlement*[15] are telling in this regard:

> *'If an arrangement changes the whole substratum of the trust then it may well be that it cannot be regarded merely as varying that trust. But if an arrangement, while leaving the substratum, effects the purpose of the original trust by other means, it may still be possible to regard that arrangement as merely varying the original trusts, even though that means employed are wholly different and even though the form is completely changed.'*

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[13] *CPT Custodian Pty Ltd v. Commissioner of State Revenue (Vic)* [2005] HCA 53.

[14] [2005] HCA 53 at p.20.

[15] (1968) WLR 899 at 905.

The question is whether the changes, which have been made, constitute 'a new charter of future rights and obligations' as observed by the High Court in *Davidson v. Chimside.*[16]

In *Roome v. Edwards (Inspector of Taxes)*[17] it was said:

> *'There are a number of obvious indicia which may help to show whether a settlement, or a settlement separate from another settlement exists. One might expect to find separate and defined property, separate trusts and separate trustees. One might also expect to find a separate disposition bring the separate settlement into existence. These indicia may be helpful, but they are not decisive.'*

The fact that a trustee newly appointed to the trust property declares that it holds the property subject to the terms of the original trust should not in the usual case be a resettlement ie. In Lord Wilberforce's words 'a settlement separate from another settlement'. This was the outcome in Farrar's Case[18] where a declaration was found to be a mere acknowledgment of a pre-existing trust in a New South Wales stamp duty context.

In many jurisdictions the particular provision in the *Trustee Act* allowing appointment of separate trustees prima facie contemplates that the trust property will be held on separate and distinct trusts.

In the Australian Capital Territory subsections 6(1), 6(5), 6(6) and 6(9) *Trustee Act 1925* (ACT) provide:

> *'(1) A new trustee may by registered deed be appointed in place of a trustee, either original or substituted, and whether appointed by the Supreme Court or otherwise.*
>
> *…*
>
> *(5) The appointment may be made for the whole or any part of the trust property.*
>
> *(6) The following provisions apply to appointments under subsection (1):*
>
> > *(a) 2 or more trustees may be appointed concurrently;*
> >
> > *(b) the number of trustees may be increased up to 4;*
> >
> > *(c) a separate set of up to 4 trustees may be appointed for any distinct part of the trust property held on trusts that are distinct from those relating to any other part of the trust property even if a new trustee is not to be appointed for the other part;*
> >
> > *(d) any existing trustee may be appointed or remain one of the separate set of trustees;*
> >
> > *(e) if only 1 trustee was originally appointed – a separate trustee may be appointed for the distinct part;*
> >
> > *(f) it is not necessary to appoint more than 1 new trustee if only 1 trustee was originally appointed or to fill up the original number of trustees if more than 2 trustees were originally appointed.*

[16] [1908] HCA 65.

[17] [1982] AC 279 at 292-293 per Lord Wilberforce.

[18] *Farrar v. Commissioner of Stamp Duties* (NSW) (1975) 5 ATR 364.

…

(9) Every new trustee appointed under this section, as well before as after all the trust property becomes by law or by conveyance or otherwise vested in him or her, shall have the same powers and discretions, and may in all respects act as if he or she had been originally appointed a trustee by the trust instrument.'

In New South Wales subsections 6(1), 6(5) and 6(8) *Trustee Act 1925* (NSW) provide:

'(1) A new trustee may by registered deed be appointed in place of a trustee, either original or substituted and whether appointed by the Court or otherwise.

…

(5) The appointment may be made for the whole or any part of the trust property, and on the appointment:

(a) two or more trustees may be appointed concurrently;

(b) the number of trustees may be increased, but not beyond four;

(c) a separate set of trustees may be appointed for any distinct part of the trust property, that is to say, for any part for the time being held on trusts distinct from those relating to any other part or parts, notwithstanding that no new trustees or trustee are or is to be appointed for other parts, provided that the number of trustees in any separate set shall not exceed four;

(d) any existing trustee may be appointed or remain one of the separate set of trustees.

…

(8) Every new trustee appointed under this section as well before as after all the trust property becomes by law or by conveyance or otherwise vested in the new trustee, shall have the same powers, authorities and discretions, and may in all respects act as if the new trustee had been originally appointed a trustee by the instrument, if any, creating the trust.'

Subsection 12(2) *Trusts Act 1973* (QLD) provides:

'On the appointment of a trustee or trustees for the whole or any part of the trust property:

…

(b) a separate set of trustees may be appointed for any part of the trust property held on trusts distinct from those relating to any other part and whether or not new trustees are or are to be appointed for any other part of the trust property; and any existing trustee may be appointed or remain 1 of the separate set of trustees or if only 1 trustee were originally appointed then 1 separate trustee may be so appointed for the part of the trust first in this paragraph mentioned.'

Section 42 of the *Trustee Act 1958* (Vic) provides:

'On the appointment of a trustee for the whole or any part of trust property:

(a) the number of trustees may, subject to the restrictions imposed by this Act on the number of trustees, be increased; and

(b) a separate set of trustees, not exceeding four, may be appointed for any part of the trust property held on trusts distinct from those relating to any other part or parts of the trust property, notwithstanding that no new trustees or trustee are or is to be appointed for other parts of the trust property, and any existing trustee may be appointed or remain one of such separate set of trustees, or, if only one trustee was originally appointed, then, save as hereinafter provided, one separate trustee may be so appointed.'

The references to '*trusts distinct from those relating to any other part*' (Qld) and '*held on trust distinct from those relating to any other part*' (ACT, NSW and Victoria) raise concerns about whether the trust deed has to specifically provide for separate and distinct trusts before there can be separate trustees appointed in respect of separate trust assets. In the writer's view this appears to be an unjustifiable conclusion. It may be that the provisions simply require the particular trust property to be discernibly held subject to the terms of the trust. However as a surfeit of caution if a split is to be pursued the necessary provisions should be set out in the trust deed.

Subsection 6(15) of the Trustee Act 1925 (ACT) provides:

'This section applies to a trust except so far as the contrary intention appears in the trust instrument.'

Subsection 6(13) of the *Trustee Act 1925* (NSW) provides:

'Except as otherwise provided in subsection (12), this section applies only if and as far as a contrary intention is not expressed in the instrument, if any, creating the trust, and shall have effect subject to the terms of that instrument and to the provisions therein contained.'

There is no specific exclusion in Victoria and Queensland. Those in pursuit of an effective split will want to make sure that the trust deed specifically allows a separate trustee to be appointed in respect of specific assets held subject to the trusts.[19]

5.4 Varying the Deed to Allow Separate Trustees

Can the power of amendment be used to allow for appointment of separate trustees where no such power existed or does the amendment amount to a resettlement. Common sense suggests, no (unless there is something in the deed which provides that a single trustee was an absolute requirement or that separation of assets and trustees was prohibited by the deed). Based on the views of Brightman J in *Hart v. Briscoe,*[20] Lord Wilberforce in *Roome v. Edwards*[21] and Mahoney J in *Kearns v. Hill*[22] the use of a power of amendment set out in the trust deed (and without any relevant imbedded limitations being breached) to allow the appointment of separate trustees to the trust assets is unlikely to be a resettlement so that a new trust estate comes into existence.

[19] The legislation in Northern Territory and Western Australia is similar. It should be noted that in all States and Territories except NT, SA and TAS the number of trustees for a private unit trust is limited to four.

[20] [1978] 1 All ER 791.

[21] [1982] AC 279.

[22] (1990) 21 NSWLR 107.

As David Raphael has observed[23]:

> *'Despite **Kearns v. Hill** and **Re Lancedale Holdings** case there is a body of law to the effect that a power of amendment is not likely to be held to extend to vary the trust in a way which would destroy its substratum: see **Re Dwyer** (1935) VLR 273; **Re Ball's Settlement Trusts** (1968) 1 WLR 899 at 904. The underlying purpose for the furtherance of which the power was initially created or conferred will be paramount: see **Duke of Bedford v. Marquess of Abercom** (1836) 11 My and Ca 312.*
>
> *However, this general principle is unlikely to be an appropriate consideration where the evident purpose of the power is to ensure maximum flexibility such as would be the case in most modern superannuation funds or discretionary trusts or unit trusts. Indeed the converse is the case. Nonetheless, as I have said in relation to the Tax Acts, it is more likely than not that Re Ball's Settlement will be followed.'*

5.5 Appointment of Separate Appointor

It is suggested immediately above that the segregation of assets to be held by separate trustees is unlikely to be a resettlement. What if the trust deed has an office of appointor and the deed is amended to provide for different appointors in respect of the different trustees. Would such an amendment be a resettlement?

The power of appointor is a fiduciary power, which must be exercised in the interests of the beneficiaries.[24] It gives the appointor no interest in the trust property.

An appointor has, simply by holding that office and wielding the power attached, no interest in the property of the trust.[25] This is notwithstanding that a Court might conclude for special purposes that the appointor is the '*owner*' of property of the trust.[26]

Provided the trust deed allows sufficient flexibility or it can be introduced by amendment the introduction of an appointor with powers restricted to appointing the trustee of say Parcel 2 assets while the limitation of the power of the original appointor to the appointment of the trustee to Parcel 1 assets appears to the writer to be an administrative matter not going to the substratum of the trust. It should not, either by using powers that already exist in the deed or by amending the deed, effect a resettlement of the trust property. The principles are the same as discussed above.

David Raphael also points out that many trust deeds will not empower the trustee to amend the deed so as to affect the appointor's power or to allow further appointors to be engaged. This is because many trust deeds provide the trustee with the power to amend the trusts but not the powers granted by the deed.

5.6 Splitting and Family Trust Elections

The relationship between the two trustees and the trust assets remains the one trust estate. If the trustee of the trust has made a family trust election pursuant to section 272-80 (Schedule 2F) of the 1936

[23] D Raphael: '*Variation & Resettlement of Trusts*' paper presented at a seminar conducted by the Taxation Institute of Australia: NSW Division on 7 April 2004 particularly at paras. 26 and 27.

[24] *Re Wiley v. Burton* [1994] FCA 1146 and *Gilbert v. Stanton* [1905] HCA 1.

[25] See *Edwards v. Klaville Pty Ltd* [1996] FCA 411.

[26] As in the case of Section 1323 of the *Corporations Act 2001* and ASIC: *In the Matter of Richstar Enterprises Pty Ltd ACN 099 071 968 (No. 9) v. Carey* [2006] FCA 1242.

Act that should continue to be effective notwithstanding the fact that an additional trustee has been appointed. The ramifications of having made a family trust election (or interposed entity election) flow from actions taken by the trustee of the trust from time to time notwithstanding the fact that the trustee is not the same person as the trustee that made the election.[27]

5.7 The CGT Events

When the original trustee disposes of a CGT asset to the additional trustee there is a change in legal title i.e. a change of ownership for the purposes of subsection 104-10(2) of the 1997 Act. However, the change of ownership does not occur if it happens '*merely because of a change of trustee*'.

CGT event E1 will not happen if no trust is created by declaration or settlement.[28] All of the reasoning above has been to the effect that there will be no declaration of trust by merely appointing a new trustee or no resettlement. CGT event E2 is not relevant because there is no other existing trust to which the CGT assets are transferred.

CGT event E3 is not relevant. CGT event E4 could be relevant in the context of a unit trust or hybrid trust.

CGT event E5 operates on the basis of a beneficiary becoming absolutely entitled as against the trustee. In the splitting approach no beneficiary becomes absolutely entitled to a CGT asset of the trust.

CGT events E6, E7 and E8 are not relevant to a splitting.

Subject to there being no resettlement triggering a CGT event E1 there should be no relevant CGT event arising on a splitting.

5.8 Splitting – Tracing Assets

This is really an asset protection topic. What if the trustee in relation to Parcel 1 assets falls into financial difficulty (for example, experiences a call on its margin lending facility against its share portfolio). Is the trustee of Parcel 2 assets protected against the claims of the creditors of the original trustee?

If the creditors arose in respect of debts incurred by trustee 1 after the Parcel 2 assets were transferred to trustee 2 the answer appears to be reasonably clear. Unless there are special circumstances eg. misrepresentation or fraud, there is no right to recover. The trustee's right to indemnity from trust assets comes into existence when the liabilities are incurred. If trustee 1 incurs liabilities after the Parcel 2 assets have been transferred to trustee 2 the creditors have no right to be subrogated to claim against assets that trustee 1 no longer has legal title to nor had at the time the liability was incurred.

A trustee is only liable for its own acts and liabilities incurred. The Trustee Acts make this plain:[29]

- Section 59(2) of the *Trustee Act 1925* (ACT) provides:

  'A trustee shall be answerable and accountable only for his or her own acts, receipts, neglects, or defaults, and not for those of any other trustee, nor for any bank, broker, or other person

[27] For example, a tax liability for family trust distributions tax arises when '*the trust confers a present entitlement to, or makes a distribution of income or capital of the trust*': subsection 27-15 1936 Act.

[28] Subsection 104-55(1).

[29] See also: NT – section 26 *Trustee Act* (NT); SA – section 35 *Trustee Act 1958* (SA); TAS – section 27 *Trustee Act 1898* (Tas); WA – section 70 *Trustee Act 1962* (WA).

with whom any trust money or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss, unless the same happens through his or her own wilful neglect or default.'[30]

- Subsection 59(2) of the *Trustee Act 1925* (NSW) provides:

  'A trustee shall be answerable and accountable only for the trustee's own acts, receipts, neglects, or defaults, and not for those of any other trustee, nor for any banker, broker, or other person with whom any trust moneys or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss, unless the same happens through the trustees own wilful neglect or default.'[31]

- Subsection 36(1) of the *Trustee Act 1958* (Vic) provides:

  'A trustee shall be chargeable only for money and securities actually received by him notwithstanding his signing any receipt for the sake of conformity, and shall be answerable and accountable only for his own acts, receipts, neglects or defaults, and not for those of any other trustee, nor for any banker, broker or other person with whom any trust money or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss unless the same happens through his own wilful default.'

- Section 71 of the *Trusts Act 1973* (Qld) provides:

  'A trustee shall be chargeable only for money and securities actually received by the trustee, notwithstanding the trustee signing any receipt for the sake of conformity; and shall be answerable and accountable only for the trustee's own acts, receipts, neglects or defaults, and not for those of any other trustee, nor those of any financial institution, broker or other person with whom any trust money or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss, unless the insufficiency, deficiency or loss occurs through the trustee's own default.'

As Dr John Glover has put it:[32]

> *'If the trust deed so provides, the powers of multiple trustees can be exercised without the concurrence of all or a majority of their number, or alternatively can be exercised by co-trustees acting unilaterally. Not infrequently one out of a body of co- trustees is given the sole responsibility for conducting a business and is made the sole signatory who can enter agreements on the business's behalf. Co-trustees, ordinarily, are not liable for the exercise of powers by other trustees to whom those powers have been exclusively allocated'*

A trustee has an equitable lien over the assets of the trust as they existed at the time the trustee incurred liabilities on behalf of the trust. That lien continues notwithstanding the fact that the person is

[30] This provision is expressly subject to the term of the trust deed: subsection59(3) *Trustee Act 1925* (ACT).

[31] This provision is expressly subject to the term of the trust deed: subsection59(3) *Trustee Act 1925* (NSW).

[32] Dr John Glover: '*Dissecting Trusts and Trusteeships: Capital Gains and State Taxation Consequences*': paper presented to Taxation Institute of Australia's 7th Annual States Taxation Conference (July 2007) at p.4 and also '*Dissecting Trusts and Trusteeship: CGT and Stamp Duty Consequences*' Vol. 36 No. 4 ATR (Nov 2007) p.201 at 203-204.

no longer the trustee but has been replaced. In *Coates v. McInerney*[33] it was argued that the right of indemnity was lost when the trustee was removed from office. Anderson J observed:

> *'It is said that under this clause only the trustee actually in office is indemnified. However, I must disagree. Any right of indemnity would arise upon the liability arising and the question is whether that right of indemnity, arising at that time, that is to say, during the holding of the office by the trustee who held office at the time that the liability was incurred, is then lost by subsequent loss of office.*
>
> *There is abundant authority that it is not so lost. I do not need to refer to all of the authorities. It is, I think, sufficient to refer to Kemtron v. Commissioner of Stamp Duties (1984) 15 ACR 627 at 634. The question is whether there is anything in clause 12 which would affect the general equitable doctrine that loss of office does not terminate the right of indemnity. In my view there is nothing in clause 12 which would modify the general equitable doctrine'.*[34]

In *Rothmore* Farms Mansfield J, when confronted with the same issue, found that the trust assets secured the indemnity as they existed from time to time. Mansfield J appears to have allowed equitable tracing into the hands of those in whom the assets were ultimately vested.[35] Equitable tracing is a very difficult topic and beyond the scope of this paper.

The reference in the decision of Anderson J in *Coates v. McInerney* to clause 12 of the deed raises issues about whether the trust deed can by its terms oust the right to indemnity. In South Australia the indemnity cannot be excluded.[36] In New South Wales the better view is that it cannot be excluded.[37] In Victoria the right to be indemnified can be excluded by the terms of the trust deed.[38] This is why it may be possible according to the terms of the trust deed to limit the right of the trustee to follow assets over which the trustee might otherwise have a lien.[39]

Notwithstanding whether or not a trustee may have a lien, the assets which trustee 1 held at the time the liability was incurred and then transferred to trustee 2 may be recoverable by the creditors of trustee 1 for a number of reasons:

- the creditors held security directly over those assets and the transfer was a breach of that security;
- trustee 2 knew that the Parcel 2 assets were depended upon by creditors for the advance of funds and was equitably bound to disgorge them when the claim was made against trustee 1;
- trustee 2 undertook to indemnify trustee 1 when the Parcel 2 assets were transferred;
- trustee 1 is an individual and the provisions of section 120 and 121 of the *Bankruptcy Act 1966* (Cth) could apply to allow the trustee in bankruptcy of trustee 1 to recover assets transferred for

[33] (1992) 6 ACCR 748.

[34] at p.749-750 of 6 ACSR 748. See also *Rothmore Farms Pty Ltd v. Belgravia Pty Ltd* [1999] FCA 745*; Moyes* v. *J&L Developments Pty Ltd (No. 2)* [2007] SASC 261 and *Collie v. Merlaw Nominees Pty Ltd* [2001] VSC.

[35] [1999] FCA 745 at paras. 182 and 184.

[36] per Debelle J in *Moyes v. J&L Developments Pty Ltd (No. 2)* [2007] SASC 261 at paras. 37 to 48.

[37] *JA Pty Ltd v. Jonco Holdings Pty Ltd* (2000) 33 ACSR 691 per Santow J at paras. 50 and 67. See also *Jacobs' Law of Trusts in Australia* (7th Ed) at p.2106.

[38] *RWG Management Ltd v. Commissioner for Corporate Affairs* [1985] VR 385 at 394-5.

[39] *Tindon Pty Ltd v. Adams and Window Concepts Pty Ltd* [2006] VSC 172.

less than market value consideration[40] or where trustee 1 transferred the assets for the main purpose of avoiding the assets becoming available to meet creditors' claims;

- in the case of a corporate trustee the *Corporations Act 2001* (Cth) becomes relevant. Section 588FC, in relation to insolvent transactions (the company being insolvent at the time of the transaction), subsection 588FE(4) in relation to uncommercial transactions and subsection 588FE(5) in relation to avoiding creditors are the most relevant.

A liquidator of trustee 1 (a corporate trustee) may be successful in clawing back property transferred to trustee 2.

The position of a corporate trustee in relation to an undervalue transaction differs from that of an individual acting as a trustee because the '**uncommercial transaction**'[41] must have been entered into when the company was insolvent or was a transaction which caused it to become insolvent. By contrast an individual acting as a trustee is exposed for up to 4 years regardless of their state of solvency where the transfer is to an associate.[42]

In relation to transactions intended to defeat creditors an individual is exposed forever.[43] By contrast a company is exposed only for 10 years.[44]

Trustee 2 may have a defence to the claim of the liquidator if it can show:

- it became a party to the transaction in good faith;
- there was no objective grounds for suspecting that trustee 1 was insolvent or about to become insolvent; and
- trustee 2 provided valuable consideration or changed its position in reliance on the transaction.[45]

As the controlling mind of trustee 2 is likely to be that of trustee 1 or they will be closely associated it is unlikely that this defence can be made out. It is possible that the third point could be satisfied if trustee 2 undertook the liabilities of trustee 1 associated with Parcel 2 assets. However, this may not be sufficient if the effect of the transfer is to make trustee 1 insolvent in any event.

The potential impact of section 197 of the *Corporations Act* needs to be considered. This provision imposes joint and several liability on Directors in respect of liabilities incurred by a corporate trustee when the trustee is not entitled to be fully indemnified out of trust assets because of:

- a breach of trust by the company;
- the company acting outside the scope of its powers as trustee;

[40] subsection 120 will allow the trustee in bankruptcy to recover back an asset transferred by way of a undervalue transaction to a related entity for a period of up to four years from the date on which the bankruptcy commenced.

[41] an '*uncommercial transaction*' is one that it might be expected a reasonable person in the company's circumstances would not have entered into having regard to the matters set out in subsection 588FB(1) of the *Corporations Act*.

[42] it is only beyond 4 years to 5 years that insolvency becomes an issue extending the clawback period.

[43] see Trustees of the Property of John Daniel *Cummins v. Cummins* [2006] HCA 6.

[44] subsection 588FE(5) *Corporations Act*.

[45] subsection 588FG(1) *Corporations Act*.

- a term of the trust denying or limiting, the company's right to be indemnified against the liability.

In the case of a split of a trust none of these things is likely to occur. In transferring assets to the new trustee, trustee 1 will be acting within the terms of the trust deed (perhaps as amended). Nothing in the terms of the trust deed need limit the recourse of trustee 1 to the assets of the trust. However, if there is an explicit provision in the deed that does limit the right to be indemnified to those assets and there is no recourse to the assets held by trustee 2 there might be potential application of section 197. Arguably, however, the right to indemnity is limited as a matter of the general law to the assets actually held by trustee 1. If this is the case then it is the fact of transfer of the assets that has limited the recourse and not the terms of the trust deed.

5.9 Trustee's Duties

All trustees are subject to duties. In the case of a trustee of a discretionary trust that duty is to:

- consider the exercise of discretion from time to time or as required by the trust deed;[46]
- not act arbitrarily or in capricious disregard of the trustees' power;
- not to delegate the decision making but exercise it personally;
- not act dishonestly or to commit a fraud on its power.

Nothing more is required of the trustee. It is not possible to conceive of a transfer of assets from trustee 1 to trustee 2 pursuant to the terms of the trust deed in itself as in any way in breach of the trustee's duties bearing in mind that it is the one trust relationship.

In any event beneficiaries of discretionary trusts have great difficulty in establishing standing to take action against trustees.[47]

5.10 The Tax Return

One of the minor irritants of trust splitting is the need to have the trustees lodge an income tax return and BAS. The question also arises as to whether or not the trustees need separately to be registered for GST (if that is relevant in the circumstances).

Subsection 161(1) of the 1936 Act requires every '*person'* to lodge a return of income when required to do so by the Commissioner. A '*person'* is defined to include '*a person in the capacity of trustee of a trust estate*'. This appears to require/allow each trustee to lodge a return of income in respect of the income derived from assets it holds in relation to the trust.

Notwithstanding this possibility nothing will happen without a tax file number. Can each of the trustees acquire its own individual tax file number?

Section 202B of the 1936 Act provides that a '*person'* may apply to the Commissioner for issue of a tax file number. Based on the definition of '*person'* each trustee appears to be entitled to apply. If the

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[46] I J Hardingham & R. Baxt 'Discretionary Trusts': (1st Ed) Butterworths (1975) pp.92-114.

[47] See generally: K. Schurgott: '*Some Trust Oddities*', paper delivered to the Taxation Institute of Australia's 20th National Convention (March 2004 Perth) pp.29-37 and also C. Call: '*Trusts in the Court*' paper delivered to the Taxation Institute of Australia's (NSW Division) Trust Intensive (November 2005) pp.50-62.

Commissioner is satisfied that the person's identity has been established the Commissioner '*shall issue*' a tax file number to the applicant subject only to:

- the Commissioner being satisfied that the person already has a tax file number;
- there not being an interim notice.[48]

It would appear that it is mandatory for the Commissioner to issue a tax file number if satisfied as to the applicant's identity. The exceptions should not apply. The legislation would appear to allow the separate trustee to obtain its own tax file number in respect of its role as trustee of the trust.

Are the trustees required to be separately registered for GST? An '*entity*' includes a '*trust*'.[49] The trustee of a trust is taken to be an entity consisting of the person who is the trustee, or the persons who are the trustees, at any given time.[50] An entity carrying on an enterprise that meets the registration turnover is required to be registered.[51]

It would appear that the split trustees cannot be split for GST purposes. This would appear to be in contrast to the position for income tax. It poses a considerable difficulty for complying with the lodgement requirements in respect of BAS. From a practical perspective the Commissioner is likely not to complain if the trustees individually register.

5.11 Trust Cloning legislation

On 24 March 2010 the TLAB6 received royal assent to give effect to the abolition of the trust cloning exceptions in CGT events E1 and E2 in the 1997 Act. The TLAB6 also contains the new fixed trust rollover rules. The changes contained in the TLAB6 will apply to CGT events happening on or after 1 November 2008.

The new fixed trust rollover may apply if assets are transferred from the trustee of a trust (***the transferring trust***) to another trust (***the receiving trust***) where certain conditions are satisfied and both the trustees of the transferring trust and the receiving trust chose to obtain the rollover relief. Paragraph 1.10 of the explanatory memorandum accompanying the TLAB6 states that:

> *'Broadly, the effect of the roll-over is to defer the making of any capital gain or capital loss in respect of the asset transfer. The cost base of beneficiaries' interests in the transferring trust is apportioned across their interests in both trusts.'*

Eligibility for the rollover relief depends on the following:

- both trusts are eligible trusts for the rollover;
- the same beneficiaries have the same interests in both trusts; and
- no exception applies.

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[48] section 202BA 1936 Act.

[49] paragraph 184-1(1)(g) GST Act.

[50] subsection 184-1(2) GST Act.

[51] section23-5 GST Act.

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(a) Eligible trusts for the rollover

For both the transferring trust and the receiving trust to be eligible trusts, beneficiaries' interests in each trust must satisfy a number of requirements. The requirements are:

- each beneficiary's membership interests in each of the trusts must be interests in, or rights relating to, the income and/or capital of the trust; and
- the nature and extent of each beneficiary's membership interests in each of the trusts must be capable of being worked out solely from t he constituent document of the trust (ie, the trust deed); and
- there must be no power for any entity (that is, including but not limited to the trustee) to:
    - material alter a beneficiary's membership interest in the trust;
    - issue or redeem membership interests in the trust at a discount of more than 10% of their market value; and
- CGT event E4 is capable of happening to all of the units and interests in each of the trusts at the transfer time; and
- the receiving trust must be a 'cleanskin' trust, being either:
    - A newly created trust; or
    - A trust with no CGT assets other than a small amount of cash or debt; and
- both the trustees of the transferring and the receiving trust choose to obtain the rollover.

(b) Same beneficiaries with the same interests

For the transferring trust and the receiving trust to have the same beneficiaries with the same interests, just after the transfer time the trusts must:

- have the same beneficiaries; and
- the receiving trust must have the same classes of membership interests that the transferring trust had just before, and has just after, the transfer time; and
- the sum of the market value of each beneficiary's membership interests of a particular class in both trusts must be the same as the sum of the market value just before the transfer time of the beneficiary's membership interests of that class in the transferring trust (disregarding any small amounts of cash or debt held by the receiving trust just before the transfer time in the calculation).

(c) Exceptions

The rollover relief is not available if any of the following exceptions applies:

- the receiving trust is a foreign trust and the rollover asset is not taxable Australian property just after the transfer time; or
- either the transferring trust or the receiving trust is a trust to which section 102K or 102S of the 1936 Act applies for the current year (that is, either trust is a corporate unit trust or a public trading trust); or
- both trusts must have the same tax choices or election in force if the absence of the mirror choice would or could have an ongoing impact on the calculation of an entity's net income or taxable income for the current year or a later income year. The choice must be in force just after the transfer time unless the trustee makes the mirror choice before the first time the choice matters for tax purposes, or it would not be reasonable to require the mirror choice to be made.

6 Social security attribution rules

Broadly speaking, income derived, and assets held by private companies and trusts are attributed to persons who ***control*** the entity, or if the person is the ***source*** of the capital held by the entity. That is, the attribution rules are subject to the:

- ***Control test*** – this test looks at who has either formal or informal control of an entity. A controller will have the income and assets of the entity included in their assessment for the purposes of determining their social security means-tested payments.
- ***Source test*** – this test looks at the person who has transferred (or gifted) property to a company or trust. It is such persons who have the transferred (or gifted) income or assets included in their social security or Department of Venterans' Affairs assessments for entitlements.

There are provisions which allow social security to exercise a discretion such that neither the control nor the source tests apply.

6.1 The gifting provisions

The asset test and the gifting provisions

The anti-avoidance provisions in the social security laws should be considered. Broadly speaking, the anti-avoidance rules relate to the asset test, and provide that if eligibility for social security entitlements is the motivation of a gift, then eligibility may not be achieved notwithstanding the decrease in one's assets as a result of a gift.

Section 1126AA of the *Social Security Act 1991* (Cth) (**'the Social Security Act'**) provides that:

> ***'Disposal of assets in income year--individuals***
>
> *Disposals to which section applies*
>
> *(1) This section applies to a disposal (the **relevant disposal**) on or after 1 July 2002 of an asset by a person who is not a member of a couple at the time of the relevant disposal.*
>
> *Increase in value of assets*

(2) If the amount of the relevant disposal, or the sum of that amount and the amounts (if any) of other disposals of assets previously made by the person during the income year in which the relevant disposal took place, exceeds $10,000, then, for the purposes of this Act, the lesser of the following amounts is to be included in the value of the person's assets for the period of 5 years starting on the day on which the relevant disposal took place:

(a) the amount of the relevant disposal;

(b) the amount by which the sum of the amount of the relevant disposal and the amounts (if any) of other disposals of assets previously made by the person during the income year in which the relevant disposal took place, exceeds $10,000.

Previous joint disposals

(3) If, during the income year in which the relevant disposal took place but before the time of the relevant disposal, the person was a member of a couple who jointly disposed of an asset, a reference in subsection (2) to the amounts (if any) of other disposals of assets previously made by the person during that income year includes a reference to one-half of the amount of the joint disposal.'

That is, gifts which exceed $10,000 in a financial year must be included in tested assets for five years after the date of disposal.

Section 1126AB of the Social Security Act provides that:

'Disposals of assets in 5 year period--individuals

Disposal to which section applies

(1) This section also applies to a disposal (the relevant disposal) on or after 1 July 2002 of an asset by a person who is not a member of a couple at the time of the relevant disposal.

Increase in value of assets

(2) If:

(a) the sum of the amount of the relevant disposal and the amounts of any previous disposals of assets made during the rolling period by the person;

less

(b) the sum of any amounts included in the value of the person's assets during the rolling period under section 1126AA, 1126AC or 1126AD or any previous application or applications of this section;

exceeds $30,000, then, for the purposes of this Act, the lesser of the following amounts is to be included in the value of the person's assets for the period of 5 years starting on the day on which the relevant disposal took place:

(c) an amount equal to the excess;

(d) the amount of the relevant disposal.

Previous joint disposals

(3) If, during the rolling period but before the time of the relevant disposal, the person was a member of a couple who jointly disposed of an asset, the reference in paragraph (2)(a) to the amounts of any previous disposals of assets made during the rolling period by the person includes a reference to one-half of the amount of the joint disposal.

Rolling period

(4) For the purposes of this section, the ***rolling period*** *is the period comprising the income year in which the relevant disposal took place and such (if any) of the 4 previous income years as occurred after 30 June 2002.*

That is, gifts which exceed $30,000 over a rolling five year period (which do not include amounts included in determining whether section 1126AA of the Social Security Act is breached) must be included in tested assets for five years after the date of disposal.

An example of the interaction of sections 1126AA and 1126AB of the Social Security Act is if gifts of $10,000 are made over four financial years. Whilst none of the gifts would breach section 1126AA of the Social Security Act, the fourth $10,000 gift (i.e. that gift made in the fourth year) would cause a breach of section 1126AB of the Social Security Act, and would need to be included in the donor's asset test for the next five years.

6.2 Couples and the gifting provisions

Sections 1126AC and 1126AD of the Social Security Act provide that for couples, one half of the amount included is attributed to each member of the couple for five years from the date of the gift.

However, if there are amounts included in both member's of the couple asset test because of a disposal by one member and the other member of the couple who did not make the gift leaves the couple, then subsections 1126AC(3) and 1126AD(3) of the Social Security Act provides that:

- The amount is removed from the assets of the non-gifting partner; and
- The amount is added back to the assets of the partner that did make the gift.

If there is a death of one of the partners, then:

- If the deceased is the partner who made the gift, the surviving member's assets do not include the amount attributed (subsections 1126AC(4) and 1126AD(4) of the Social Security Act); and
- If the deceased is the partner that did not make the gift, then the full amount is added to the survivor's assets (subsections 1126AC(5) and 1126AD(5) of the Social Security Act).

6.3 Undervalue transfers to trusts

Undervalue transfers made to trusts after 7.30pm on 9 May 2000 may also be considered for the purposes of social security assessments.

If undervalue transfers are made to a trust, then the source test for the purposes of control of a trust will be satisfied. The result will be that the trust is deemed to be a 'controlled private trust' (see section 127V of the Social Security Act).

Further, the transferor is deemed to be an 'attributed stakeholder', with the result that for the purposes of social security assessment, the income and assets of the trust may be considered as those of the transferor (see sections 1207X, 1207Y and 1208E of the Social Security Act).

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